The Money and Bond Markets in August

Conditions in the money market during August were little changed on average from those prevailing during July. Member bank borrowings from the Federal Reserve and net borrowed reserves averaged about the same as their July levels, and Federal funds rates averaged somewhat higher. Effective July 31, the Federal Reserve Regulation D was amended to eliminate a reduction in demand deposits subject to reserve requirements, which had formerly resulted from some banks' transactions with their foreign branches. Adjusted for the estimated effects of these transactions prior to the revision of Regulation D, the money supply grew at an annual rate of about 4 percent during the first seven months of the year, compared with about 2½ percent before that adjustment. During August, however, the money supply on the new basis declined at an estimated annual rate of more than 5 percent, bringing the growth for the year down to 3 percent. Total bank credit, as estimated from data for the final Wednesday of each month and adjusted to allow for bank sales of assets to affiliates and foreign branches, increased at an annual rate of about 3½ percent in the first eight months of the year.

Most short-term interest rates edged downward during August. Offering rates on commercial paper—both dealer placed and directly placed—and bankers' acceptances were reduced, and Treasury bill rates also declined for much of the month in the face of strong demand from a wide variety of investors. The Treasury raised $2.1 billion in new cash during August through the sale of a "strip" of short-term bills, the maturities for which demand had been most persistent. In the face of the augmented supply, rates on bills maturing within two months rose sharply, more than retracing their earlier declines.

Prices of most intermediate- and long-term Treasury notes and bonds declined over the month, while prices of several short-term issues increased slightly. The Treasury's August refunding in the early part of the month was conducted in a favorable atmosphere which was encouraged by Congressional extension to the end of the year of the 10 percent income tax surcharge. All but 13.8 percent of the privately held notes maturing August 15 were exchanged into a new eighteen-month 7¾ percent note which was priced to yield 7.82 percent, the highest yield offered by the Treasury on a direct coupon obligation in more than a century. Prices of outstanding Treasury notes and bonds rose early in the month, but declined in reaction to the devaluation of the French franc on August 8 and the ensuing uncertainty over international monetary developments. Prices subsequently revived on expectations of heavy reinvestment demand from the proceeds of the sale of oil leases by the state of Alaska. Toward the end of the month, however, prices were tending downward in sympathy with other areas of the capital market.

Prices of seasoned corporate bonds rose during the first half of the month but, after a series of poor receptions on aggressively priced new issues, prices gave way during the latter half of the month. In the municipal bond market, prices declined sharply and steadily, after a short-lived rally at the beginning of the month, in part because of concern that proposed tax legislation would reduce the attractiveness of these securities to individual investors.

BANK RESERVES AND THE MONEY MARKET

On average, conditions in the money market during August were little changed from those of July. Member bank borrowings from the Federal Reserve Banks averaged $1,211 million during August (see Table I), compared with $1,312 million in July. Net borrowed reserves averaged $1,054 million in August, compared with $1,045 million in July. Federal funds traded at rates averaging about 9.2 percent during August, compared with 8.6 percent in July. Day-to-day conditions in the money market fluctuated widely, however, in large measure reflecting shifting strategies of reserve management by the member banks.

The money market was quite firm during the first statement week of August, as banks tended to concentrate their demands for reserves in the Federal funds market. In order to temper the developing tautness, the Federal Reserve injected reserves steadily in early August through the purchase of Treasury and Federal agency securities and bankers' acceptances under repurchase agreements. In spite of these substantial reserve injections, Federal funds traded predominantly at rates ranging from 9½ percent to 10¼ percent from August 1 to 6 (see Chart I). On the weekly settlement day for all member banks, Wednesday, August 6, some Federal funds traded at rates as high as 11 percent, matching the record established three weeks earlier.

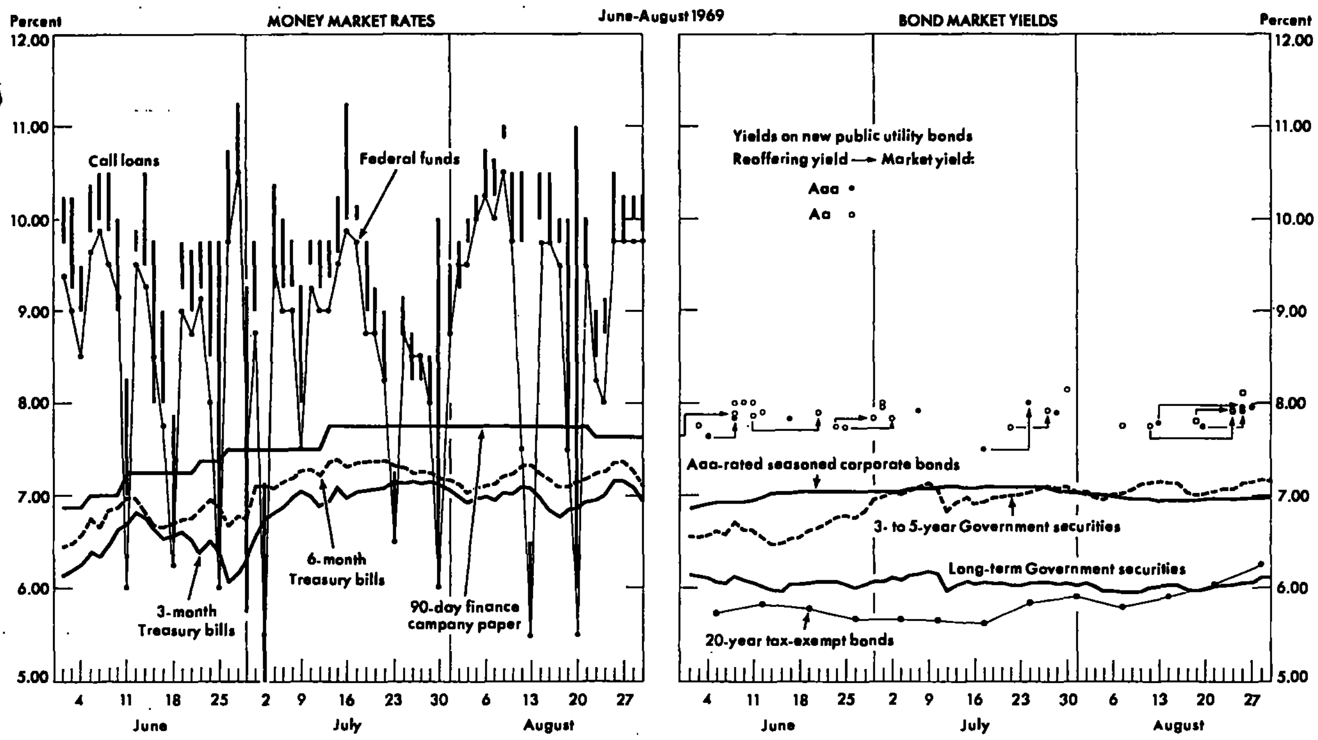
There were some striking similarities between the money market conditions that prevailed during the two ensuing statement weeks. Conditions were very firm before each weekend, with Federal funds trading in a 9½ to 10¾ percent range on the first two days of the statement week ended on August 13 and in a 9¼ to 10¼ percent range a week later. In both weeks the Federal funds market began to ease on Monday and the effective rate declined to 7½ percent on Tuesday and finally to 5½ percent on Wednesday. Also in both weeks, the Federal Reserve injected reserves in order to temper the tautness before the weekend, and later absorbed reserves through matched sale-purchase transactions in order to counter the easing tendencies on the last two days of each statement week.

Despite the broad similarities in the tone of the money market during the weeks that ended on August 13 and August 20, there were some important differences in reserve management practices. In the earlier week, member banks borrowed heavily from the Federal Reserve over the weekend, thereby building up excess reserves that subsequently cascaded into the money market. In the following week, however, early borrowing from the Reserve Banks was more restrained and the resulting accumulation

Chart I

SELECTED INTEREST RATES

June-August 1969



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Daily range of rates posted by major New York City banks on call loans (in Federal funds) secured by United States Government securities (a point indicates the absence of any range); offering rates for directly placed finance company paper; the effective rate on Federal funds (the rate most representative of the transactions executed); closing bid rates (quoted in terms of rate of discount) on newest outstanding three- and six-month Treasury bills.

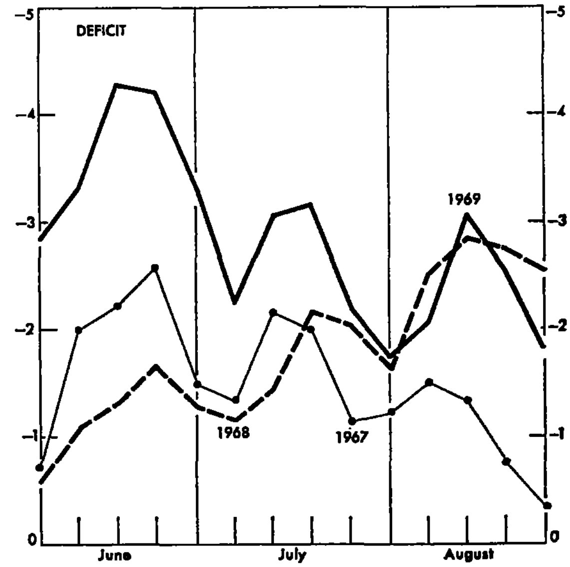
BOND MARKET YIELDS QUOTED: Yields on new Aaa- and Aa-rated public utility bonds (arrows point from underwriting syndicate reoffering yield on a given issue to market yield on the same issue immediately after it has been released from syndicate restrictions); daily averages of yields on seasoned Aaa-rated corporate bonds; daily averages of yields on long-term Government securities (bonds due or callable in ten years or more) and on Government securities due in three to five years, computed on the basis of closing bid prices; Thursday averages of yields on twenty seasoned twenty-year tax-exempt bonds (carrying Moody's ratings of Aaa, Aa, A, and Baa).

Sources: Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, Moody's Investors Service, and The Weekly Bond Buyer.

of excess reserves much more modest. The easing of pressures in the money market after the weekend apparently reflected the decision of a number of major banks to sell Federal funds in large volume rather than risk being left with sizable reserve excesses at the end of the statement week, as had occurred a week earlier.

As a whole, the member banks succeeded in sharply reducing their excess reserves to \$29 million in the week ended on August 20 from \$216 million in the previous week. Related to this, a relatively large amount of reserve deficiencies was carried over into the following statement week, and conditions in the money market were firm on the first day of the latter period when Federal funds traded predominantly at 9½ percent. The basic reserve position of the major money market banks quickly began improving, however (see Chart II), and the Federal funds rate eased to 8¼ percent on Friday, August 22, and to 8 percent on Monday. Subsequently, as a number of banks which were required to cover reserve deficiencies carried over from the previous week bid aggressively for Federal funds, the rate was driven up to 10¼ percent before the settlement on Wednesday, August 27.

Chart II
BASIC RESERVE POSITIONS OF MAJOR MONEY MARKET BANKS



Note: Calculation of the basic reserve position is illustrated in Table II.

The Board of Governors of the Federal Reserve System has closed a loophole in its Regulation D which had formerly permitted member banks with foreign branches to reduce their net demand deposits subject to reserve requirements. In the past, the so-called "bills payable checks" and "London drafts" used in settling transactions involving foreign branches (primarily in Euro-dollars) were not required to be included in the deposits of the remitting bank, even though they could be deducted as cash items in process of collection from the demand deposits of the receiving bank. Effective July 31, Regulation D was amended to include such checks in demand deposits subject to reserve requirements. The immediate consequence was an increase of approximately \$3 billion in net demand deposits subject to reserve requirements. This increase occurred largely at the major New York City banks, which are the biggest borrowers in the Euro-dollar market.

Adjusted for the estimated magnitude of the former understatement of demand deposits, the money supply (privately held demand deposits plus currency outside banks) grew at a seasonally adjusted annual rate of 4 percent during the first seven months of 1969, compared with the 2½ percent rate of growth previously indicated. The money supply is estimated to have declined during August at an annual rate of over 5 percent. Total member bank deposits subject to reserve requirements (the so-called "bank credit proxy"), plus banks' liabilities to their foreign branches, declined at a seasonally adjusted annual rate of 10 percent in August, compared with 2 percent over the previous seven months. Because of the proliferation of nondeposit means of raising funds by banks, this measure has become an increasingly poor indicator of trends in bank credit. The latter, on the basis of last-Wednesday-of-the-month figures, rose at a seasonally adjusted annual rate of 2¼ percent on average over the first eight months of the year. After adjustment for asset sales to affiliates and foreign branches, the rate of growth in bank credit increased to 3½ percent.

THE GOVERNMENT SECURITIES MARKET

Along with other short-term rates, most Treasury bill rates declined during the month of August. Bills were in strong demand for most of the month from a wide variety of investors—banks, corporations, public funds, foreign central banks, and dealers. After declining steadily for the first week of August, rates edged higher amid exceptionally tight money market conditions for a few days prior to midmonth, but then resumed their decline on August 13.

Responding to the especially heavy demand for sho[rt]-term bills, the Treasury announced on August 14 that it was planning to fill its current cash needs by offering a "strip" of $2.1 billion of bills with an average maturity of forty-five days. The offering consisted of a $300 million addition to each of the seven outstanding weekly bill issues maturing from September 18 to October 30. Tenders for multiples of $7,000, to be divided equally among the seven issues, were due August 20. Payment was made on August 25, and commercial banks were permitted to pay for subscriptions for their own accounts and for their customers by crediting Treasury Tax and Loan Accounts. The announcement of the "strip" offering was favorably received in the market and provoked only a slight reaction on the rates of some of the affected issues. Rates generally continued to decline up to the time of the auction on August 20. Bidding for the "strip" proved less aggressive than anticipated, however, and the average issuing rate was established at 5.544 percent, with tenders accepted over an unusually wide range of nearly 50 basis points. The "strip" opened trading at about 6.85 percent, the discount from the issuing price representing the estimated value to banks of the privilege of payment by crediting Tax and Loan Accounts.

When trading resumed the following day, rates on the seven reopened issues shot up about 25 to 50 basis points and rates on most other bills rose about 1 to 7 basis points. Rates continued to creep higher until the final two days of the month, when they again declined substantially in the face of strong demand for bills. For the month as a whole, rates on most bills were 2 to 25 basis points lower, except in the area of augmented supply where rates closed generally 30 to 60 basis points higher.

There was active interest in each of the regular Treasury bill auctions held during August. In the final auction of the month, held on Friday, August 29 (advanced from Monday in observance of the Labor Day holiday), the average issuing rates on the three- and six-month bills were 7.014 percent and 7.166 percent, respectively (see Table III), 16 and 15 basis points below the rates established in the auction held a month earlier. In the monthly auction of nine- and twelve-month bills on August 26, average issuing rates of 7.387 percent and 7.340 percent, respectively, were little changed from the rates set in June and July.

The Treasury's August refunding occupied the center of attention in the market for Treasury coupon issues during the early part of the month. On July 30, the Treasury announced that holders of the $3.4 billion 6 percent note maturing August 15, 1969 would be offered in exchange a 7¾ percent eighteen-month note priced to yield about 7.82 percent. These terms were received enthusiastically, and prices of intermediate-term issues rose as much as ½ point on the following day, reflecting the absence of a longer term note offering and the decision not to prerefund $6.2 billion of bonds maturing October 1, 1969. The new 7¾ percent note immediately moved to a premium in "when-issued" trading, which went as high as ²⁄₆₄ above the issue price before the subscription books closed on August 6. All but 13.8 percent of the $3.2 billion of the maturing issue held by the public was tendered for the new 7¾ percent note. This "attrition", although somewhat higher than predicted by many market participants, was considerably below the 20 percent figure which, it appeared, the Treasury had been prepared to accept.

Prices of outstanding Treasury notes and bonds also rose in early August amid the favorable atmosphere surrounding the refunding and the Congressional passage of an extension of the 10 percent income tax surcharge through the remainder of the year. Prices then slipped a bit over the next few days in a largely technical reaction to the earlier gains. Following the announcement on Friday, August 8, of the 11.1 percent devaluation of the French franc, additional mild losses occurred and the downward drift continued over the next few days amidst uncertainty over international monetary developments. Prices subsequently rose again in response to expectations of reinvestment demand from the proceeds of the sale by the state of Alaska of North Slope oil leases on September 10. Toward the end of the month, however, prices declined, partly in reaction to the relatively weak bidding in the "strip" bill auction, the deterioration of the corporate and municipal bond markets, and the anticipation of the Treasury's forthcoming refunding. Intermediate-term issues came under selling pressure as dealers prepared for a possible long note offering in exchange for the October 1, 1969 bonds. Over the month as a whole, prices of most issues maturing beyond two years were ¼ to 1¼ lower, while prices of shorter term issues were mostly ⅟₁₆ to ½ higher.

OTHER SECURITIES MARKETS

Prices of corporate bonds rose during the first week of August in a constructive atmosphere fostered by the Congressional passage of the tax surcharge extension. Prices declined in the wake of the devaluation of the French franc on August 8, later recovered partially, and resumed their decline in the latter half of the month. Aggressively priced new issues were well received early in the month but ran into increasingly stiff investor resistance thereafter. The generally deteriorating atmosphere in the new-issue sector of the market is illustrated

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, AUGUST 1969

In millions of dollars; (+) denotes increase (—) decrease in excess reserves

Factors	Changes in daily averages— week ended on				Net changes
	Aug. 6	Aug. 13	Aug. 20	Aug. 27	
"Market" factors					
Member bank required reserves	— 338	+ 173	— 486	+ 399	— 252
Operating transactions (subtotal)	— 122	— 314	+ 495	— 335	— 276
Federal Reserve float	+ 5	+ 38	+ 391	— 458	— 24
Treasury operations*	+ 318	— 147	+ 259	— 153	+ 277
Gold and foreign account	— 30	+ 10	+ 8	— 4	— 16
Currency outside banks	— 210	— 278	— 315	+ 288	— 515
Other Federal Reserve accounts (net)†	— 207	+ 63	+153	— 9	—
Total "market" factors	—460	— 141	+ 9	+ 64	— 528
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 741	— 86	— 90	+ 103	+ 668
Outright holdings:					
Government securities	+ 241	— 71	+ 355	+ 61	+ 586
Bankers' acceptances	— 1	—	+ 1	—	—
Repurchase agreements:					
Government securities	+ 431	+ 2	— 400	+ 35	+ 68
Bankers' acceptances	+ 22	—	— 19	+ 3	+ 6
Federal agency obligations	+ 48	— 17	— 27	+ 4	+ 8
Member bank borrowings	— 180	+ 235	— 107	— 20	— 72
Other loans, discounts, and advances	—	—	—	—	—
Total	+ 561	+ 149	— 196	+ 82	+ 596
Excess reserves	+ 101	+ 8	— 187	+ 146	+ 68
	Daily average levels				
Member bank:					
Total reserves, including vault cash	27,004	26,839	27,138	26,885	26,967‡
Required reserves	26,796	26,623	27,109	26,710	26,810‡
Excess reserves	208	216	29	175	157‡
Borrowings	1,093	1,328	1,221	1,201	1,211‡
Free, or net borrowed (—), reserves	— 885	—1,112	—1,192	—1,026	—1,054‡
Nonborrowed reserves	25,911	25,511	25,917	25,684	25,756‡
Net carry-over, excess or deficit (—)§	91	133	188	43	114‡
	Changes in Wednesday levels				
System account holdings of Government securities maturing in:					
Less than one year	+1,898	— 934	+ 858	+ 530	+2,352
More than one year	—	—	— 408	—	— 408
Total	+1,898	— 934	+ 450	+ 530	+1,944

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Includes assets denominated in foreign currencies.
‡ Average for four weeks ended on August 27.
§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS AUGUST 1969

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on				Averages of four weeks ended on Aug. 27
	Aug. 6	Aug. 13	Aug. 20	Aug. 27	
Eight banks in New York City					
Reserve excess or deficiency(—)*	6	65	— 61	46	14
Less borrowings from Reserve Banks	18	118	136	53	81
Less net interbank Federal funds purchases or sales(—)	— 11	446	— 152	— 292	— 2
Gross purchases	*1,766*	*1,750*	*1,571*	*1,397*	1,621
Gross sales	*1,777*	*1,304*	*1,723*	*1,688*	1,623
Equals net basic reserve surplus or deficit(—)	— 1	— 499	— 45	285	— 65
Net loans to Government securities dealers	617	386	335	358	424
Net carry-over, excess or deficit(—)†	44	22	50	— 19	24
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)*	44	18	— 26	— 52	— 4
Less borrowings from Reserve Banks	183	366	267	196	253
Less net interbank Federal funds purchases or sales(—)	1,913	2,192	2,224	1,846	2,044
Gross purchases	*3,854*	*3,928*	*4,023*	*3,749*	*3,889*
Gross sales	*1,942*	*1,738*	*1,799*	*1,904*	*1,84[illegible]*
Equals net basic reserve surplus or deficit(—)	—2,051	—2,540	—2,517	—2,093	—2,30[illegible]
Net loans to Government securities dealers	— 123	— 49	— 72	— 130	— 93
Net carry-over, excess or deficit(—)†	— 24	25	41	17	15

Note: Because of rounding, figures do not necessarily add to totals.
* Reserves held after all adjustments applicable to the reporting period less required reserves and carry-over reserve deficiencies.
† Not reflected in data above.

Table III

AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—August 1969				
	Aug. 4	Aug. 11	Aug. 18	Aug. 25	Aug. 29
Three-month	6.994	7.081	6.856	7.098	7.014
Six-month	7.085	7.277	7.121	7.293	7.166

Maturities	Monthly auction dates—June-August 1969		
	June 24	July 24	August 26
Nine-month	7.387	7.407	7.387
One-year	7.342	7.313	7.340

* Interest rates on bills are quoted in terms of a 360-day year, with the d[illegible] counts from par as the return on the face amount of the bills payable [illegible] maturity. Bond yield equivalents, related to the amount actually invest[illegible] would be slightly higher.

by the experience of four Aa-rated utility issues, with five years of call protection, which came to market at approximately one-week intervals during the month. The first sold out quickly at a yield of 7.75 percent, 25 basis points below the record yield placed on comparable issues in mid-June. The second, which was marketed shortly after the franc devaluation, encountered a lackluster response from investors at the same yield. The third, offered a week later, was even more poorly received at a yield of 7.80 percent. When the substantial unsold balances of these issues were released from syndicate price restrictions on August 25, their prices declined enough to raise the yields about 15 basis points. The next day a similarly rated issue was marketed at a record yield of 8.10 percent and encountered only a fair investor reception.

After a sharp rally in municipal bond prices during the first week of the month, yields on tax-exempt securities rose to record levels. The early rally was sparked by the modification of Congressional plans that had earlier threatened to diminish the attractiveness of investment in municipal securities by commercial banks, by far the biggest buyers of these issues. It became apparent, however, that the market's response had been overly exuberant and a reaction set in. Thereafter, the atmosphere in the municipal bond market steadily deteriorated amid continuing concern about proposals in the Congress to restrict the tax-exempt status of these securities. *The Weekly Bond Buyer's* twenty-bond index of yields on municipal securities, after dropping 13 basis points during the first week of August, rose 46 basis points over the next three weeks to a record 6.26 percent. The volume of new tax-exempt bond flotations during the month was relatively light, $750 million as compared with the average of $1 billion during the previous seven months and $1.7 billion in August 1968. A heavy volume of short-term issues was sold, however.